

Regulation 1669. Demonstration, Display and Use of Property Held for Resale - General.

(a) In General. A purchaser of tangible personal property who gives a resale certificate therefor, and who uses the property solely for demonstration or display while holding it for sale in the regular course of business, is not required to pay tax on account of such use. Except as otherwise provided in this regulation, if the property is used for any purpose other than or in addition to demonstration or display, such as making deliveries, personal use of employees, etc., the purchaser must include in the measure of the tax reported the purchase price of the property. Tax applies to the subsequent retail sale of the property.

(b) Sale to Sales Representatives for Demonstration. Tax applies to sales by dealers to their sales representatives of tangible personal property to be used for demonstration. It is presumed that any such tangible personal property will be used for purposes in addition to demonstration, and any resale certificates given for such property by sales representatives to dealers will be questioned, even if the sales representatives hold seller's permits.

(c) Rental to Sales Representatives for Demonstration. A dealer who rents property to sales representatives is regarded as making a continuous sale of the property and must collect and pay tax on the rental receipts unless tax has been paid measured by the purchase price of the property rented. The dealer must also include in the measure of the tax reported the gross receipts from the retail sale of such property following its rental to the sales representatives.

(d) Loans to Schools for Educational or Training Program. The loan by any retailer of any tangible personal property to any school district for an educational program conducted by the district is exempt from the use tax.

(e) Donations of Property.

(1) In General. Operative January 1, 1989, use tax does not apply to tangible personal property withdrawn from a resale inventory for the purpose of making a charitable contribution to a qualified organization located in this state. This exemption applies only to property which has been purchased for resale and subsequently donated without any use other than retention, demonstration or display while holding it for sale in the regular course of business. For purposes of this regulation, property purchased for the purpose of incorporation into a manufactured article is regarded as having been purchased for resale. For the period January 1, 1989 through October 1, 1989, this exemption is available only to retailers. Effective October 2, 1989, this exemption is available to all sellers.

Property purchased specifically for donation to a qualified organization remains subject to the tax. As provided in section 6094.5 of the Revenue and Taxation Code, a person is guilty of a misdemeanor if a resale certificate is issued for property which he or she knows at the time of purchase will be donated rather than resold. Such improper use of a certificate may cause that person to become liable for penalties called for by Sections 6072, 6094.5, 6484 or 6485 of the Revenue and Taxation Code.

Demonstration, Display and Use of Property Held for Resale - General.

(2) “Qualified Organization”. For purposes of this regulation, “qualified organization” means and includes any organization described in Section 170(b)(1)(A) of the Internal Revenue Code including but not limited to:

A. Religious organizations, e.g., synagogues, churches and associations of churches;

B. Charitable organizations, e.g., the Red Cross, the Salvation Army, nonprofit schools and hospitals, and medical assistance and research groups;

C. Organizations operated for educational, scientific, or literary purposes including nonprofit museums, art galleries, and performing arts groups;

D. Organizations operated for the protection of children or animals;

E. Fraternal lodges if the donated property is to be used for charitable purposes and not for the benefit of the members; and

F. The United States, this state and any political subdivision of this state.

Effective January 1, 1990, a nonprofit museum will not be considered a “qualified organization” unless the donated property is used exclusively for purposes of display to the public within the museum and the museum either:

(1) Has a significant portion of its display space open to the public without charge during its normal operating hours;

(2) Has its entire display space open to the public without charge for at least six of its normal operating hours during each month of operation; or

(3) Has its entire display space open without charge to a segment of the student or adult population for educational purposes.

(f) Use of Rental Value as a Measure of Tax.

(1) Where Applicable.

(A) Accommodation Loans. If the use of property purchased under a resale certificate is limited to the loan of property to customers as an accommodation while awaiting delivery of property purchased or leased from the lender or while property is being repaired for customers by the lender, the measure of tax is the fair rental value of the property for the duration of each loan so made. The lender must also include in the measure of the tax reported the gross receipts from the retail sales of such property following its loan to customers.

Demonstration, Display and Use of Property Held for Resale - General.

(B) **Property Used Both for Demonstration and Other Purposes.** If property purchased under a resale certificate is used frequently for purposes of demonstration or display while holding it for sale in the regular course of business and is used partly for other purposes, the measure of tax is the fair rental value of the property for the period of such other use or uses. The gross receipts from the retail sale of the property after such use or uses must be included in the measure of tax.

This applies, for example, to a situation in which a dealer or lessor purchases property without tax paid on the purchase price and uses it personally, or allows sales representatives, sales managers, partners, corporate officers, or other authorized persons to use the property, for purposes in addition to demonstration and display.

The property must, in fact, be used frequently for demonstration or display. Mere incidental use for demonstration or display will not suffice. The dealer or lessor must maintain evidence substantiating the exempt use for examination by Board auditors.

(C) **Aircraft Dealers.** The use of aircraft withdrawn from inventory for flight instruction and personal and business use is subject to tax. Tax may be reported on the fair hourly rental value of such use provided the requirements of (B) above are met.

(D) **Mobile Transportation Equipment Leased While Being Held for Resale.** If the use of mobile transportation equipment purchased under a resale certificate is limited to leasing the equipment, the purchaser may elect to pay use tax liability measured by the fair rental value if the election is made on or before the due date of a return for the period in which the equipment is first leased. The election must be made by reporting tax measured by the fair rental value on the return for that period. Tax must thereafter be paid with the return for each reporting period, measured by the fair rental value, whether the equipment is within or without this state. The election may not be revoked with respect to the equipment as to which it is made.

This election is available to any purchaser who leases mobile transportation equipment, other than a person exempt from use tax under Revenue and Taxation Code section 6352, and such purchaser may properly issue a resale certificate for the limited purpose of reporting use tax liability based on fair rental value.

1. **Fair Rental Value.** "Fair rental value" means the rentals required by the lease, except where the Board determines the rental receipts are nominal. Fair rental value does not include any payment made by the lessee to reimburse the lessor for the lessor's use tax, whether or not the amount is separately stated, and regardless of how the charge is designated in the lease documentation and invoices. Lump-sum charges to the lessee will be assumed to include reimbursement for the lessor's use tax whether or not any statement to that effect is made to the lessee.

Example:

Assuming a 6 percent tax rate, if the invoice to the lessee states "rental \$100, tax reimbursement to the lessor \$6", "rental \$100, sales and use taxes \$6", or similar wording, the fair rental value is \$100. If the

invoice to the lessee states “rental \$106” and makes no reference to reimbursement, the fair rental value is \$100 (\$106 divided by 1.06). Assuming a 6.5 percent tax rate, the fair rental value is \$99.53 (\$106 divided by 1.065).

Fair rental value includes any deficiency payment required from the lessee on disposition of mobile transportation equipment at the termination of an open-end lease and such payment is subject to tax. Any surplus rentals, however, which are returned to the lessee at the termination of an open-end lease may be deducted from the total fair rental value reported for the period in which the surplus rentals are returned. In the alternative, a refund may be claimed for any tax paid within the applicable statute of limitations period on such surplus rentals.

Fair rental value includes any capitalized cost reduction payment, which is a one-time payment by the lessee at the start of the lease to reduce the lessor’s investment and the lessee’s rentals. The payment may either be reported for the period in which it became due from the lessee or it may be reported in equal increments over the lease term. On early termination of such a lease, any unreported portion of the capitalized cost reduction payment shall be reported for the period in which termination occurred.

The term “fair rental value” includes any payments required by the lease, including amounts paid for personal property taxes on the leased property, whether assessed directly against the lessee or against the lessor, but does not include amounts paid to the lessor for:

a. Collection costs, including attorney’s fees, court costs, repossession charges, and storage fees; but tax does apply to any delinquent rental payments, including those collected in court action;

b. Insuring, repairing or refurbishing the leased property following a default;

c. Cost incurred in defending a court action or paying a tort judgement arising out of the lessee’s operation of the leased property, or any premiums paid on insurance policies covering such court actions or tort judgements;

d. Cost incurred in disposing of the leased property at expiration or earlier termination of the lease;

e. Late charges and interest thereon for failing to pay the rentals timely;

f. Separately stated optional insurance charges, maintenance or warranty contracts.

g. Personal property taxes assessed against personal property where a bank or financial corporation is the lessor.

2. Tax Application. Tax applies to fair rental value for all periods during which the mobile transportation equipment is leased even though the lessee may not make the required rental payments.

Demonstration, Display and Use of Property Held for Resale - General.

Tax on fair rental value does not apply either (a) for periods during which the equipment is not leased and is merely held for lease; or (b), for periods after the lessor has formally demanded return of the equipment if the lessee wrongfully retains possession of the property and is not required to make rental payments under the lease.

(2) Measuring Fair Rental Value. The fair rental value for property other than mobile transportation equipment is the amount which normally is charged by the lender for the rental of similar property under similar circumstances. If the lender does not rent similar property, the rental rate which generally is charged by others in the area is to be used.

Note: Authority: Section 7051, Revenue and Taxation Code.

Reference: Sections 6092.1, 6094, 6243.1, 6244 and 6403, Revenue and Taxation Code.